

DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

Amendment and Compilation of Chapter 3-123
Hawaii Administrative Rules
October 14, 1997

SUMMARY

1. §§3-123-1 to 3-123-3 are amended.
2. §§3-123-7 to 3-1230-9 are amended.
3. §§3-123-11 to 3-123-14 are amended.
4. §3-123-16 to 3-123-21 are amended.
5. §3-123-22 is repealed.
6. §3-123-24 is amended.
7. Chapter 123 is compiled.

HAWAII ADMINISTRATIVE RULES

TITLE 3

DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

SUBTITLE 11

PROCUREMENT POLICY BOARD

CHAPTER 123

COST PRINCIPLES

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§3-123-1 Applicability of cost principles. (a)
The cost principles and procedures contained in this

chapter shall be used to determine the allowability of incurred costs for the purpose of reimbursing costs under contract provisions which provide for the reimbursement of costs.

(b) The cost principles and procedures set forth in this chapter may be used as guidance in:

- (1) The establishment of contract cost estimates and prices under contracts awarded where the award may not be based on adequate price competition, as in subchapters 6, 7, and 9, chapter 122;
 - (2) The establishment of price adjustments for contract changes including contracts that have been let on the basis of competitive sealed bidding or otherwise based on adequate price competition;
 - (3) The pricing of termination for convenience settlements; and
 - (4) Any other situation in which cost analysis is used.
- (c) These cost principles are not applicable to:
- (1) The establishment of prices under contracts awarded on the basis of competitive sealed bidding or based on adequate price competition rather than the analysis of individual, specific cost elements, except that this chapter does apply to the establishment of adjustments of price for changes made to such contracts;
 - (2) Prices which are fixed by law or regulation; and
 - (3) Prices which are based on established catalogue prices or market prices as defined in section 3-120-2. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §§103D-202, 103D-601) (Imp: HRS §103D-601)

§3-123-2 Allowable costs. (a) Any contract cost proposed for estimating purposes or invoiced for cost-reimbursement purposes shall be allowable to the extent provided in the contract and, if inconsistent with these cost principles, approved as a deviation under section 3-123-24. The total allowable cost of a contract is the sum of the allowable direct costs actually incurred in the performance of the contract in accordance with its terms, plus the properly allocable portion of the allowable indirect costs, less any

applicable credits such as discounts, rebates, and property disposal income.

(b) All costs shall be accounted for in accordance with generally accepted accounting principles and in a manner that is consistent with the contractor's usual accounting practices in charging costs to its other activities. In pricing a proposal, a contractor shall estimate costs in a manner consistent with its cost accounting practices used in accumulating and reporting costs.

(c) Costs may be allowed only to the extent they are:

- (1) Appropriate, as defined in section 3-123-3;
- (2) Allocable, as defined in section 3-123-4;
- (3) Lawful under any applicable law;
- (4) Not unallowable under sections 3-123-5 through 3-123-15 and 3-123-17 through 3-123-20; and
- (5) In the case of costs invoiced for reimbursement, actually incurred or accrued and accounted for in accordance with generally accepted accounting principles.
[Eff 12/15/95; am and comp NOV 17 1997]
(Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-3 Appropriate costs. A cost is appropriate if, in its nature or amount, it does not exceed that which would be incurred by an ordinarily prudent person in the conduct of a competitive similar business. In determining the appropriateness of a given cost, consideration shall be given to:

- (1) Requirements imposed by the contract terms and conditions;
- (2) Whether the cost is of a type generally recognized as ordinary and necessary for the conduct of the contractor's business or the performance of the contract;
- (3) The restraints inherent in, and the requirements imposed by, such factors as generally accepted sound business practices, arms' length bargaining, and federal and state laws and regulations;
- (4) The action that a prudent business manager would take under the circumstances, including general public policy and considering responsibilities to the owners of the business, employees, customers, and the

- State;
- (5) Significant deviations from the contractor's established practices which may unjustifiably increase the contract costs;
 - (6) The guidelines, policies, and limitations the State of Hawaii establishes for travel related expenses for its employees; and
 - (7) Any other relevant circumstances. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-4 Allocable costs. (a) A cost is allocable if it is assignable or chargeable to one or more cost objectives in accordance with relative benefits received and if it:

- (1) Is incurred specifically for the contract;
- (2) Benefits both the contract and other work, and can be distributed to both in reasonable proportion to the benefits received; or
- (3) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective may not be evident.

(b) Costs are allocable as direct or indirect costs. Similar costs such as those incurred for the same purpose, in like circumstances, shall be treated consistently either as direct costs or indirect costs except as provided by these rules. When a cost is treated as a direct cost in respect to one cost objective, it and all similar costs shall be treated as a direct cost for all cost objectives. Further, all costs similar to those included in any indirect cost pool shall be treated as indirect costs. All distributions to cost objectives from a cost pool shall be on the same basis.

(c) A direct cost is any cost which can be identified specifically with a particular final cost objective. A direct cost shall be allocated only to its specific cost objective. To be allowable, a direct cost must be incurred in accordance with the terms of the contract.

(d) An indirect cost is one identified with no specific final cost objective or with more than one final cost objective. Indirect costs are those remaining to be allocated to the several final cost objectives after direct costs have been determined and charged directly to the contract or other work as

appropriate. Any direct costs of minor dollar amount may be treated as indirect costs, provided that such treatment produces substantially the same results as treating the cost as a direct cost.

- (1) Indirect costs shall be accumulated into logical cost groups with consideration of the reasons for incurring the costs. Each group should be distributed to cost objectives benefiting from the costs in the group. Each indirect cost group shall be distributed to the cost objectives substantially in proportion to the benefits received by the cost objectives. The number and composition of the groups and the method of distribution should not unduly complicate indirect cost allocation where substantially the same results could be achieved through less precise methods.
- (2) The contractor's method of indirect cost group distribution may require examination when:
 - (A) Any substantial difference exists between the cost patterns of the work performed under the contract and the contractor's other work;
 - (B) Any significant change occurs in the nature of the business, the extent of subcontracting, fixed asset improvement programs, inventories, the volume of sales and production, manufacturing processes, the contractor's products, or other relevant circumstances; or
 - (C) Indirect cost groups developed for a contractor's primary location are applied to off-site locations. Separate cost groups for costs allocable to off-site locations may be necessary to distribute the contractor's costs on the basis of the benefits accruing to the appropriate cost objectives.
- (3) The base period for indirect cost allocation is the one in which such costs are incurred and accumulated for distribution to work performed in that period. Normally, the base period is the contractor's fiscal year. A different base period may be appropriate under unusual circumstances. In such cases, an appropriate period should be agreed to in

advance. [Eff 12/15/95;
comp NOV 17 1997] (Auth: HRS §§103D-202,
103D-601) (Imp: HRS §103D-601)

§3-123-5 Specific costs--advertising. (a)
Advertising costs are those incurred in using any
advertising media when the advertiser has control over
the form and content of what will appear, the media in
which it will appear, or when it will appear.
Advertising media include newspapers, magazines, radio,
television, direct mail, trade papers, billboards,
window displays, conventions, exhibits, free samples,
and the like. All advertising costs except those set
forth in subsection (b) are unallowable.

(b) The only allowable advertising costs are
those for:

- (1) The recruitment of personnel;
- (2) The procurement of scarce items;
- (3) The disposal of scrap or surplus material;
and
- (4) The listing of a business's name and location
in a classified directory. [Eff 12/15/95;
comp NOV 17 1997] (Auth: HRS §§103D-202,
103D-601) (Imp: HRS §103D-601)

§3-123-6 Specific costs--bad debts. Bad debts
include losses arising from uncollectible accounts and
other claims, such as dishonored checks, uncollected
employee advances, and related collection and legal
costs. All bad debt costs are unallowable. [Eff
12/15/95; comp NOV 17 1997] (Auth: HRS §§103D-202,
103D-601) (Imp: HRS §103D-601)

§3-123-7 Specific costs--contingencies. (a)
Contingency costs are contributions to a reserve
account for unforeseen costs. Such contingency costs
are unallowable except as provided in subsection (b).

(b) For the purpose of establishing a contract
cost estimate or price in advance of performance of the
contract, recognition of uncertainties within a
reasonably anticipated range of costs may be required
and is not prohibited by this subsection. However,
where contract clauses are present which serve to
remove risks from the contractor, there shall not be
included in the contract price a contingency factor for

such risks. Further, contributions to a reserve for self-insurance in lieu of, and not in excess of, commercially available liability insurance premiums are allowable as an indirect charge. These contributions are not allowable, however, for contributions to a reserve account maintained to cover the anticipated costs of a self-insured retention plan or allowable deductible in connection with general commercial liability, automobile liability, builder's risk or other property damage insurance if, at the time of the submission of its proposal, the insurance coverage contemplated by the contractor for the project included such a self-insured retention or deductible. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-8 Specific costs--depreciation and use allowances. (a) Depreciation and use allowances, that is, the allowance made for fully depreciated assets, are allowable to compensate contractors for the use of buildings, capital improvements, and equipment or for the provision of such facilities on a standby basis for subsequent use when such facilities are temporarily idle because of suspensions or delays not caused by the contractor, not reasonably foreseeable, and not otherwise avoidable when the contract was awarded. Depreciation is a method of allocating the acquisition cost of an asset to periods of its useful life. Useful life refers to the asset's period of economic usefulness in the particular contractor's operation as distinguished from its physical life. Use allowances provide compensation in lieu of depreciation or other equivalent costs. Consequently, depreciation and use allowances may not be combined to compensate contractors for the use of any one type of property.

(b) The computation of depreciation or use allowances shall be based on acquisition costs. When the acquisition costs are unknown, reasonable estimates may be used.

(c) Depreciation shall be computed using any generally accepted method, provided that the method is consistently applied and results in equitable charges considering the use of the property. The straight-line method of depreciation is preferred unless the circumstances warrant some other method. However, the State will accept any method which is accepted by the Internal Revenue Service.

(d) In order to compensate the contractor for use of depreciated, contractor-owned property which has been fully depreciated on the contractor's books and records and is being used in the performance of the contract, use allowances may be allowed as a cost of that contract. Use allowances are allowable, provided that they are computed in accordance with an established industry or government schedule or other method mutually agreed upon by the parties. If a schedule is not used, factors to consider in establishing the allowance are the original cost, remaining estimated useful life, the reasonable fair market value, and the effect of any increased maintenance or decreased efficiency. Under no circumstances, however, shall the cumulative use allowance for any item of property over the course of the project exceed the actual market value of that item.

(e) No depreciation or use allowance will be permitted for equipment, tools, or other items having a purchase price for that new item or equivalent of less than one thousand dollars (\$1,000). [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-9 Specific costs--entertainment. (a) Entertainment costs are unallowable and include costs of amusements, social activities, and incidental costs relating thereto, such as meals, beverages, lodging, transportation, and gratuities.

(b) Nothing herein shall make unallowable a legitimate expense for job related employee health, welfare, food service, or lodging costs; except that, where a net profit is generated by such services, it shall be treated as a credit as provided in section 3-123-21. Costs incurred for meetings or conferences, including, but not limited to, costs of food, rental facilities, and transportation are not allowable except where the primary purpose of incurring such cost is the dissemination of technical information or the establishment of specific project policies, such as a partnering conference. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-10 Specific costs--fines and penalties.

Fines and penalties include all costs incurred as the result of violations of, or failure to comply with, federal, state, and local laws and regulations. Fines and penalties are unallowable costs unless incurred as a direct result of compliance with specific provisions of the contract or written instructions of the procurement officer. [Eff 12/15/95; comp NOV 17 1997] (Auth: HRS §§103D-202, 103D-601) (Imp: HRS §103D-601)

§3-123-11 Specific costs--gifts, contributions, and donations. Gifts, contributions, and donations are unallowable. A gift is property transferred to another person without the person providing return consideration of equivalent value. Contributions and donations are property transferred to a nonprofit institution which are not transferred in exchange for supplies or services of equivalent fair market value rendered by a nonprofit institution. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-12 Specific costs--interest expense. Interest, whether actual or imputed, is an unallowable cost. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-13 Specific costs--losses incurred under other contracts. A loss incurred under one contract may not be charged to any other contract. A loss is the excess of costs over income earned under a particular contract. Losses may include both direct and indirect costs. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-14 Specific costs--material costs. (a) Material costs are allowable, subject to subsections (b) and (c). Material costs are the costs of all supplies, including raw materials, parts, and components (whether acquired by purchase from an outside source or acquired by transfer from any division, subsidiary, or affiliate under the common control of the contractor), which are acquired in order

to perform the contract. In determining material costs, consideration shall be given to appropriate spoilage, appropriate inventory losses, and appropriate overages.

(b) Material costs shall include adjustments for all available discounts, refunds, rebates, and allowances which the contractor may take under the circumstances, and for credits for proceeds the contractor received or may receive from salvage and material returned to suppliers.

(c) Allowance for all materials transferred from any division including the division performing the contract, subsidiary, or affiliate under the common control of the contractor shall be made on the basis of costs incurred by the transferor, except the transfer may be made at the established price provided that the price of materials is not determined to be unreasonable by the procurement officer, the price is not higher than the transferor's current sales price to its most favored customer for a like quantity under similar payment and delivery conditions, and the price is established either:

- (1) By the established catalogue price; or
- (2) By the lowest price obtained as a result of competitive procurements conducted with other businesses that normally produce the item in similar quantities. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-15 Specific costs--taxes. (a) Except as limited in subsection (b), all allocable taxes which the contractor is required to pay and which are paid and accrued in accordance with generally accepted accounting principles are allowable.

- (b) The following costs are unallowable:
- (1) Federal, state, and local income taxes;
 - (2) All taxes from which the contractor could have obtained an exemption, but failed to do so, except where the administrative cost of obtaining the exemption would have exceeded the tax savings realized from the exemption;
 - (3) Any interest, fines, or penalties paid on delinquent taxes unless incurred at the written direction of the procurement officer; and
 - (4) Income tax accruals designed to account for

the tax effects of differences between taxable income and pretax income as reflected by the contractor's books of account and financial statements.

(c) Any refund of taxes which were allowed as a direct cost under the contract shall be credited to the contract. Any refund of taxes which were allowed as an indirect cost under a contract shall be credited to the indirect cost pool applicable to any contracts being priced or costs being reimbursed during the period in which the refund is made.

(d) Direct government charges for services, such as water, or capital improvements, such as sidewalks, are not considered taxes and allowable costs. [Eff 12/15/95; comp NOV 17 1997] (Auth: HRS §§103D-202, 103D-601) (Imp: HRS §103D-601)

§3-123-16 Costs requiring prior approval to be allowable as direct costs. The costs described in sections 3-123-17 through 3-123-20 are allowable as direct costs to the extent that they have been approved in advance in writing by the procurement officer. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-17 Pre-contract costs. Pre-contract costs are those incurred after the contract award in anticipation of, and prior to, the notice to proceed. Such costs are allowable to the extent that they would have been allowable if incurred after the date of the notice to proceed; provided that, in the case of a cost-reimbursement type contract, a special provision must be inserted in the contract setting forth the period of time and maximum amount of cost which will be covered as allowable pre-contract costs. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-18 Bid and proposal costs. Bid and proposal costs are allowable as direct costs only to the extent that they are specifically permitted by a provision of the contract or solicitation document. Otherwise, such costs are not allowable as either direct or indirect costs. Bid and proposal costs are the costs incurred in preparing, submitting, and

supporting bids and proposals including proposals for the charges for change work within the scope of the contract. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-19 Insurance. (a) Ordinary and necessary insurance costs are normally allowable as indirect costs. Direct insurance costs are the costs of obtaining insurance in connection with performance of the contract or contributions to a reserve account for the purchase of self-insurance. Self-insurance contributions are allowable only to the extent of the cost to the contractor to obtain similar insurance.

(b) Insurance costs may be approved as a direct cost only if the insurance is specifically required for the performance of the contract.

(c) Actual losses which should have been covered by permissible insurance or were expressly covered by self-insurance are unallowable unless the parties expressly agree otherwise in the terms of the contract. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-20 Litigation costs. Litigation costs incident to the contract are allowable as indirect costs in accordance with these cost principles except that costs incurred in litigation by or against the State are unallowable. Litigation costs include all filing fees, legal fees, expert witness fees, and all other costs involved in litigating claims before an administrative board or in court. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-21 Applicable credits. (a) Applicable credits are receipts or price reductions which offset or reduce expenditures allocable to contracts as direct or indirect costs. Examples include purchase discounts, rebates, allowances, recoveries or indemnification for losses, sale of scrap and surplus equipment and materials, adjustments for overpayments or erroneous charges, and income from employee recreational or incidental services and foods sales.

(b) Credits shall be applied to reduce related direct or indirect costs.

(c) The State shall be entitled to a cash refund if the related expenditures have been paid to the contractor under a cost-reimbursement type contract. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §103D-601) (Imp: HRS §103D-601)

§3-123-22 REPEALED. [R]

§3-123-23 Use of federal cost principles. (a) In dealing with contractors operating according to federal cost principles, such as Federal Acquisition Regulations, 48 C.F.R. Part 31 (1993), the procurement officer, after notifying the contractor, may use the federal cost principles as guidance in contract negotiations, subject to subsection (b).

(b) All requirements set forth in federal assistance instruments applicable to contracts let by the State under a federal assistance program must be satisfied. Therefore, to the extent that the cost principles which are specified in the assistance instrument conflict with these cost principles, the former shall control. [Eff 12/15/95; comp NOV 17 1997] (Auth: HRS §§103D-202, 103D-601) (Imp: HRS §103D-601)

§3-123-24 Authority to deviate from cost principles. When the best interest of the State would be served by a deviation, the procurement officer may deviate from the cost principles set forth in this chapter; provided that a written determination shall be made by the procurement officer specifying the reasons for the deviation. A copy of the determination shall be filed promptly with the head of a purchasing agency and the determination shall be effective only upon approval by the head of a purchasing agency and upon incorporation into the contract. However, to be reimbursed, all costs must be reasonable, lawful, allocable, and accounted for in accordance with generally accepted accounting principles and a deviation shall not contravene this principle. [Eff 12/15/95; am and comp NOV 17 1997] (Auth: HRS §§103D-202, 103D-601) (Imp: HRS §103D-601)

Amendments to and compilation of chapter 123, title 3, Hawaii Administrative Rules, on the Summary Page dated October 14, 1997 were adopted on October 14, 1997 following a public hearing held on September 22, 1997 in Honolulu, Hawaii; and via video conference from Honolulu, Hawaii on September 23, 1997 to Hilo, Hawaii; Wailuku, Maui; and Lihue, Kauai; after public notice was given in the Honolulu Star-Bulletin, Hawaii Tribune-Herald, West Hawaii Today, The Maui News, and The Garden Island on August 22, 1997.

They shall take effect ten days after filing with the Office of the Lieutenant Governor.

ROBERT E. OYAMA
Chairperson
Procurement Policy Board

SAM CALLEJO
State Comptroller

APPROVED:

BENJAMIN J. CAYETANO
Governor
State of Hawaii

Dated: _____

Filed

APPROVED AS TO FORM:

Deputy Attorney General